

Multi-Page™			DANIELLE BRIAN			
INDEX			PAGE			
1	Appearances	3	1	62	5-27-97 News Release	165
2	Examination	3	2	63	POGO Spring 1998 Newsletter	170
3	By Mr. Manos	191	3	64	Department of Justice News Release 2-13-98	171
4	By Mr. Lequette	229	4	65	Handwritten Note	173
5	By Mr. McCune	236	5	66	"POGO's Methods"	174
6	Correction Page	237	6	67	"Legal Resources"	178
7	Signature Page	237	7	68	7-24-98 Letter from Danielle Brian	187
8	Reporter's Certificate	258	8	69	Letter from James Shaw to POGO	193
9			9	70	Status Summary - California Crude Oil Underpriced	191
10			10	71	Legal Citations	207
11			11	72	Message from James Shaw 9-1-98	207
12			12	73	Letter from Dave Hubbard of the U.S. Department of the Interior	212
13			13	74	Written Submission for the Record by Danielle Brian 6-17-98	218
14			14			
15			15			
16			16			
17			17			
18			18			
19			19			
20			20			
21			21			
22			22			
23			23			
24			24			
25			25			

EXHIBIT INDEX			Page 1			
1	NO.	DESCRIPTION	PAGE	1	APPEARANCES	Page 6
2	27	POGO Brief History	9	2	Counsel for the Relators/Plaintiffs:	
3	28	www.pogo.com	19	3	Hite, Wynn, Mayall, and Ventresca	
4	29	POGO Advertisement	20	4	398 West Building, Suite 880	
5	30	5-30-94 Letter to Rich Click from Danielle Brian	28	5	Birmingham, Alabama 35203-3713	
6	31	6-15-95 Letter to Hon. Brooks Firestone from Robert Rendall	31	6	BY: MR. GLENN THREATT	
7	32	7-8-98 1st Memo to Danielle Brian from Bob Rendall	35	7	Peckard, Peckard & Johnson	
8	33	7-30-94 Memo to Danielle Brian from Bob Rendall	39	8	495 West 1100 South, Suite 350	
9	34	7-21-94 Letter to FOIA Officer from Danielle Brian	43	9	Salt Lake City, UT 84106-1889	
10	35	9-26-94 Letter to FOIA Officer from Danielle Brian	46	10	BY: MR. VON PECKARD	
11	36	9-29-94 Letter to Danielle Brian	49	11	Provost Umphrey	
12	37	Copy of Business Card of Jeff Long	52	12	480 Park Street	
13	38	10-10-94 Report	53	13	P.O. Box 4585	
14	39	10-12-94 Letter to Danielle Brian from U.S. Department of the Interior	57	14	Beaumont, Texas 77704	
15	40	"The Great Oil Rip-off"	58	15	BY: MR. MICHAEL A. HAVARD	
16	41	"Rogue Bureaucracy" by William F. Robinson, Jr.	61	16	Hite, Patterson & Roach, L.L.P.	
17	42	10-28-94 Letter to Danielle Brian from U.S. Department of the Interior	62	17	112 East Pecan Street	
18	43	11-8-94 Letter to Danielle Brian from Capital Cities/ABC	66	18	Suite 2700	
19	44	12-8-94 Letter to Danielle Brian from		19	San Antonio, Texas 78205	
20				20	BY: MR. MICHAEL ANGELOVICH	
21				21	Veiper, Lipfert, Bechard, McPherson & Hand	
22				22	111 Bagby, Suite 400	
23				23	Houston, Texas 77002	
24				24	BY: MR. MICHAEL JYRON	
25				25	MR. KEITH O. SPECKELMEIER	
					Elbertson Smith	
					1100 West 11th Street	
					Suite 1000	
					Mobile, Alabama 36602	

EXHIBIT INDEX			Page 1			
1	45	1-13-95 Letter to Danielle Brian from U.S. Department of the Interior	70	1	Counsel for the Defendant Amoco	Page 7
2	46A	April 1993 POGO "Department of Interior Looks the Other Way"	72	2	Mirkland & Ellis	
3	46B	POGO Press Release	72	3	100 East Randolph Drive	
4	47	4-24-95 POGO Letter to Bob Armstrong	88	4	Chicago, Illinois 60601	
5	48	12-8-93 POGO Letter to FOIA Officer	94	5	BY: MR. STEVEN C. LOBELEY	
6	49A	March 1995 POGO "With a Mink and a Mud"	96	6	Counsel for the Defendant Canadian Oxy Offshore:	
7	49B	POGO Press Release	96	7	Coville & Thompson, P.C.	
8	50	Letter to Danielle Brian from Bob	101	8	801 Main Street, Suite 4000	
9	51	7-8-96 Letter to Danielle Brian from U.S. Department of the Interior	102	9	Dallas, Texas 75202-3793	
10	52A	August 1996 POGO "Wait! There is more money to collect"	104	10	BY: MR. LARRY JOHNSON	
11	52B	POGO Press Release	104	11	Counsel for the Defendants Conoco, Kerr-McGraw, Phillips and Shell:	
12	53	8-22-94 Letter to POGO from Bryan Whitworth	113	12	Fulbright & Jarowski, P.C.	
13	54	9-24-94 Letter to Mr. Whitworth from Danielle Brian	113	13	1101 McKinney, Suite 500	
14	55	1-30-97 Report "Background Information on California Oil Valuation Issue and New Valuation Regulations"	114	14	Houston, Texas 77010 3095	
15	56	Timeline of California Crude Oil Issue	115	15	BY: MR. DANIEL M. MCCLUNE	
16	57	2-11-97 Letter to Danielle Brian from U.S. Department of the Interior	118	16	Counsel for the Defendant Shell:	
17	58	POGO Spring 1997 Newsletter	120	17	Jackman & Kelly	
18	59	Written Statement of Danielle Brian	123	18	100 Pennsylvania Avenue, N.W., Suite 100	
19	60	9-19-94 Letter to Joel Kersch from Danielle Brian, with Attachment	135	19	Washington, DC 20004	
20	61	12-3-94 Letter to James Baker from George Miller	162	20	BY: MR. L. POE LEGGETTE	
21				21	Counsel for the Defendant Marathon Oil Company:	
22				22	Baker & Boice, L.L.P.	
23				23	One Shell Plaza, Suite 1300	
24				24	Houston, Texas 77002-4993	
25				25	BY: MR. MARK W. ROBECK	
					Counsel for the Defendant Oxy:	
					McKenna & Conio, L.L.P.	
					2100 Bank One Center	
					Dallas, Texas 75201-1370	
					BY: MR. WILLIAM R. STOUTON	

CAN THE UNITED STATES INCREASE OIL ROYALTIES?

HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
INFORMATION, AND TECHNOLOGY
OF THE

COMMITTEE ON GOVERNMENT
REFORM AND OVERSIGHT
HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

SECOND SESSION

JUNE 17, 1996

Printed for the use of the Committee on Government Reform and Oversight



U.S. GOVERNMENT PRINTING OFFICE

45-977

WASHINGTON : 1997

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-055688-8

Multi-Page™

DANIELLE BRIAN

Page 23

Page 20

1 A. Let me reread it.
 2 Q. Okay.
 3 MR. MCCLURE: Ms. Manos, what is the exhibit
 4 number?
 5 MS MANOS: 287
 6 (Brian Exhibit No. 29 marked for
 7 identification.)
 8
 9 A. Yes, I'm comfortable with what it says.
 10 Q. (By Ms. Manos) Okay. Now I'm going to ask to have
 11 marked Exhibit No. 29 and ask whether you recognize that
 12 document?
 13 A. The entire document?
 14 Q. Yes.
 15 MR. V. PACKARD: I'm sorry. Do you have an
 16 extra copy?
 17 A. Okay.
 18 Q. (By Ms. Manos) Do you recognize this exhibit?
 19 A. Yes, I do.
 20 Q. Okay. When was it prepared?
 21 A. It would have to be two years ago. It was for our
 22 annual fund raiser and it was the 15th anniversary. So, it
 23 would have been '96.
 24 Q. And you say "annual fund raiser." What does that

1 documents that were under seal, for example, in that lawsuit?
 2 A. Certainly not.
 3 Q. And did you ever have any discussions with him about
 4 the allegations in this complaint, in the complaint that you
 5 filed?
 6 A. Yes.
 7 Q. When did you have discussions with him about those
 8 allegations?
 9 A. Well, he was, in fact, the person who in -- at a
 10 Christmas party in 1993 suggested that it might be a good thing
 11 for ROGO to look into whether on Federal leases there had been
 12 an underpayment of royalties.
 13 Q. Okay. And what was his basis for saying that? Did
 14 he tell you? Why did he think it would be a good thing to look
 15 into?
 16 A. He just knew the kind of work we did and knew there
 17 were ongoing issues in the State of California and thought it
 18 would be something that might be of interest at the Federal
 19 level as well.
 20 Q. Okay. And that was in December of '93, you said, a
 21 Christmas party in '93. Did you actually begin looking into it
 22 at that point?
 23 A. Yes, shortly after. Well, yeah, after Christmas
 24 vacation.
 25 Q. Shortly, would that be earlier than six months

Page 21

Page 24

1 does?
 2 A. It's a reception that we hold typically in the fall.
 3 Q. To try to solicit contributions?
 4 A. Yeah. I mean, to be honest, we usually just break
 5 even or maybe make \$1,000 off it.
 6 Q. Did you help prepare this document?
 7 A. Yes, I did.
 8 Q. And the front Page 2, although it's not numbered,
 9 has an executive director's message. Did you prepare that
 10 message?
 11 A. Yes, I did.
 12 Q. And in the second paragraph -- in the middle of the
 13 second paragraph of that letter says that, "We still believe
 14 the best way to keep the Government honest is to work with
 15 people inside the system and let the Government's own documents
 16 speak for themselves." Is that consistent with the -- ROGO's
 17 methods that we looked at earlier?
 18 A. I have to look because that was another goal which
 19 is, I think, different from our methods. Well, it certainly
 20 isn't inconsistent.
 21 Q. Okay. Is that the way ROGO normally operates?
 22 A. It's one of the ways we operate.
 23 Q. Okay. Is it the way -- withdraw that question. Let
 24 me -- flip over, if you will, please, and they're not numbered
 25 but the page that starts "anthology."

1 after?
 2 A. Oh, yeah. I started in beginning of '94 making
 3 phone calls to as many people as I could to start sending out
 4 my net to see what information I could collect.
 5 Q. Okay. On the next page of this document, it lists a
 6 number of people and organizations that I guess ROGO is giving
 7 special thanks to. I'd like to ask you about one of those
 8 people. Martin Lobel, who is he?
 9 A. He's also from that firm.
 10 Q. Okay. Is he a partner in that firm?
 11 A. Yes.
 12 Q. Do you know whether he worked on the Long Beach
 13 litigation?
 14 A. I suspect he did.
 15 Q. Have you ever received any information from him
 16 about the Long Beach case?
 17 A. No.
 18 Q. Have you ever received any documents from him that
 19 were under seal in that case?
 20 A. No.
 21 Q. Have you ever discussed with him the allegations in
 22 the complaint that you filed?
 23 A. Yes.
 24 Q. Okay. And when did you have that discussion with
 25 him?

Page 22

Page 25

1 A. Yeah.
 2 Q. Is that an accurate description of ROGO's
 3 methodology?
 4 A. Well, as best as you can combine 15 years of work
 5 into one page.
 6 Q. We'll come back to this after we have some more
 7 facts. But in the meantime, if you could switch over to the
 8 next page where it says "ROGO's board of directors." I'd like
 9 to ask you a question about one of the directors.
 10 Who is he?
 11 A. He was at the time the chair of our board and he
 12 works for a law firm, Lobel, Novins & Lamont.
 13 Q. And was that law firm involved in the Long Beach
 14 litigation?
 15 A. Yes, it was.
 16 Q. And did he, in fact, represent the State of
 17 California, the State Lands Commission in at lawsuit?
 18 A. Yes, he did.
 19 Q. Did he ever provide you any information about that
 20 lawsuit?
 21 A. Not about that lawsuit, no.
 22 Q. And did he ever provide you any documents from that
 23 lawsuit?
 24 A. No, he didn't.
 25 Q. Okay. And so, you've never received from him any

1 A. I have on occasion spoken to him throughout the last
 2 three years.
 3 Q. Okay. Do you recall the first time you had a
 4 conversation with him about the allegations in the complaint
 5 that you filed?
 6 A. I would suspect it would probably be in early '94.
 7 Q. So, after you had the conversation with Henry Banta
 8 at the Christmas party?
 9 A. It was actually at their firm's Christmas party.
 10 So, he may even have been during that discussion.
 11 Q. Okay. When you had that discussion, did Henry Banta
 12 tell you what the allegations in the Long Beach case were?
 13 A. It really wasn't relevant because the Long Beach
 14 case I knew was over and it didn't come up.
 15 Q. Okay. So, why did he say you thought there were --
 16 you said -- I believe the word you used was either "continuing"
 17 or "ongoing" issues in California. Why did he believe that?
 18 A. Well, he continues that -- I believe the firm
 19 continues to represent the State of California. And there are
 20 undervaluation problems separate from the Long Beach
 21 litigation.
 22 Q. Are there undervaluation problems in any cases that
 23 have been filed against any of the defendants in this case?
 24 A. I'm not aware of any litigation that's ongoing in
 25 the State of California.

Page 20 - Page 25

CONTENTS

Hearing held on June 17, 1996	Page 1
Statement of:	
Armstrong, Robert L., Assistant Secretary of the Interior, Land and Minerals Management, U.S. Department of the Interior	56
Calvert, Ken, a Representative in Congress from the State of California ...	10
McMahon, M. Brian, attorney for the city of Long Beach, trustee for the State of California, accompanied by Robert Shannon, assistant city attorney, city of Long Beach; and James McCabe, deputy city attorney, city of Long Beach	68
Quartermen, Cynthia, Director, Minerals Management Service, Department of the Interior, accompanied by Robert Beausieu, economist, Office of Policy Analysis, Department of the Interior; Abraham E. Haspel, Acting Principal Deputy Assistant Secretary for Policy and International Affairs, Office of Policy and International Affairs, Department of Energy, accompanied by Robert Speir, economist, Office of Oil and Natural Gas Policy, Department of Energy	21
Letters, statements, etc., submitted for the record by:	
Calvert, Ken, a Representative in Congress from the State of California: Letter dated May 30, 1996	11
Prepared statement of	14
Maloney, Hon. Carolyn M., a Representative in Congress from the State of New York: Letter dated March 29, 1994	67
Testimony of the Project on Government Oversight	8
McMahon, M. Brian, attorney for the city of Long Beach, trustee for the State of California, prepared statement of	75
Quartermen, Cynthia, Director, Minerals Management Service, Department of the Interior, prepared statement of	24

Multi-Page™

DANIELLE BRIAN

Page 218

Page 221

1 Q. So, it had been 11 months?

2 A. It had been a year

3 Q. And how long has Ken Star been carrying on?

4 A. I don't defend him.

5 Q. Well.

6 A. I bet you Monica Lewinski's not still on the stand,

7 though

8 (Brian Exhibit No. 74 marked for
9 identification.)

10 Q. (By Mr. Leggett) We have marked a document as
11 Exhibit 74. Can you tell me what that is?

12 A. This was my written submission for Carol Maloney and
13 Steve Horn's hearings in '96

14 Q. Okay. So, this was actually submitted?

15 A. I actually don't know if it went into the record or

16 not.

17 Q. Did you intend for it to go into the record?

18 A. Yes.

19 Q. Okay. Why do you think it might not have gone?

20 A. Because I think I may have forgotten to give it to
21 the right person because it wasn't that important to me.

22 Q. It was not that important to you?

23 A. No. That hearing was more important than my

24 submission, for the record.

25 Q. What was your involvement in that hearing?

26 A. I persuaded Congresswoman Maloney to get Chairman
27 Horn to hold the hearing and I worked with the staff
28 extensively and helped draft questions for the witnesses that
29 were presented by the Government.

30 Q. Okay. Direct your attention to the third page.

31 1994. Do you see that paragraph toward the top, "After decades
32 of an aggressive policy of see no evil"

33 A. Yes.

34 Q. -- "MMS finally bestirred itself into a small step
35 embarrassed by the 320 million obtained by California," on and
36 on and on, estimate of 400 million. You then note that,
37 "Blindfolded by the first report of the Project on Government
38 Oversight and stoned by an ABC news report, the department
39 resorted to the ancient dodge, an interagency task force." Do
40 you know what a blindfold is?

41 A. Yes. I do. It's an instrument of torture. Oh, you
42 had the definition for me?

43 Q. Yes.

44 A. Was I pretty right?

45 Q. I think you've defined it well. Thank you.

46 Reference to the exhibit withdrawn.

47 A. I actually have to say that there is an inaccuracy
48 there because the task force had begun before our report came

Page 220

Page 223

1 out. I mean, significantly before.

2 Q. And indeed rather than considering Mr. Armstrong's
3 task force an ancient Dodge in your 1994 letter to him, you
4 credited him for creating the task force, did you not?

5 A. Yes, I did.

6 Q. Okay. Explain the apparent inconsistencies.

7 A. Because by then I knew that the task force wasn't
8 getting too far and that June of --

9 Q. Of '96?

10 A. June of '96. And that -- let me see my -- I got the
11 draft of the report. I'm sorry. I just need to figure out the
12 timing on this. Right. So, I had the draft of the interagency
13 task force report and I had the notice that -- in fact, Bob
14 Speir had received a phone call from Dave Hubbard. I got this
15 memo through FOIA that a letter written by Speir who was the
16 DOE representative on the task force responding to a phone
17 message he had from Dave Hubbard. In fact, it was in my fourth
18 report and I'd like to quote from it, now that you're bringing
19 the point up. No, my fourth report. No, we don't have it.

20 Q. In the interest of my own time --

21 A. Okay. I'll tell you.

22 Q. -- I'm going to have to withdraw the question
23 because I submit what you're about to say is not responsive.
24 What you've written here is that at the time that they created
25 the task force, they were intending to report to an ancient

1 dodge?

2 A. And I acknowledge that that's not fair. By the time
3 I wrote this, it wasn't initially an ancient dodge. It's the
4 results of it that was the ancient dodge was because what Dave

5 Hubbard was saying in his phone call to Bob Speir was -- well,
6 what Speir's interpretation what he said was, "Dave, I got your
7 phone call. I can't believe that Cynthia," which I took to

8 mean Cynthia Quartermann, "has asked you to have us scrub all
9 the numbers out of the draft report." The only explanation I
10 can have for that is that you don't want them to be FOIA-able
11 and you want deniability so the public won't know how much can
12 be collected from the State of California leases on Federal
13 land.

14 Q. So, in retrospect, you think the task force was a
15 dodge despite the fact that they issued bills?

16 A. In retrospect, I think the task force left by
17 themselves would have been. But I think the public pressure
18 that was put on them because I was able to get documents that
19 were not publicly available to some extent stopped that from
20 happening.

21 Q. But your intent -- but your statement here suggests
22 that Mr. Armstrong intended simply to dodge the issue of the
23 task force?

24 A. I apologize if it appears that way. You're right.
25 That was a careless sentence.

1 Q. Well, let's go two more paragraphs. "Unfortunately
2 this report does not signal the dawn of a new day at the
3 department. Nothing in the department's dismal record of
4 negligence, misfeasance, and incompetence provides any help
5 that MMS is on the brink of doing better. I fully understand
6 that to accuse a whole Government agency of bad faith including
7 its politically appointed leadership over several
8 administrations is a very serious matter." It doesn't sound to
9 me as if you were being careless in calling it a dodge. Does
10 it seem that way now?

11 A. No, I'm not -- I'm not apologizing for anything
12 other than the fact that initially I didn't believe the
13 interagency task force was a dodge. What I found over time was
14 that it was going in that direction.

15 Q. Okay. Now, having leveled this broadside at the
16 department which we'll come back to in a moment, you further
17 add at the bottom of the same page, second sentence from the
18 bottom, "MMS will seek to justify this position," a position
19 that the use of MMS prices are not appropriate market values,
20 "by giving an issue leading to its regulations. On the next
21 page, second, "They will claim that in some mysterious ways
22 that the need to cushion in their interpretation of the
23 regulation their long-standing practice. Of course, it is
24 precisely their long-standing imbecile practice that has cost
25 the public hundreds of millions of dollars." These were not

1 careless statements, were they?

2 A. No, they weren't. I still think they're true.

3 Q. Okay. Well, you invite us to test them on the prior
4 page. "The first test is whether MMS has any colorable excuse
5 for not pursuing at least the 856 million found by the
6 interagency report to have been lost through the
7 undervaluation." Do we have the interagency report as an
8 exhibit already?

9 (Discussion off the record.)

10 MR. MCCLURE: Are you imposing a six-hour
11 time limit on this deposition, Counsel?

12 MR. V. PACKARD: Yes.

13 MR. MCCLURE: We're going to use our full
14 six hours then.

15 MR. V. PACKARD: I think that's the Court's
16 order, isn't it?

17 MR. MCCLURE: That, I guess, is subject to
18 some interpretation and question. But I want to
19 know what your position is because you're in control
20 of the witness.

21 MR. V. PACKARD: I was just going based on
22 what he said about finishing up. We're trying to
23 meet schedules at the airport.

years later. Why would the team leader believe that MMS and the Interior Department were stalling and who was stalling the report?

Ms. QUARTERMAN. I cannot respond to Mr. Hubbard's e-mail message. I don't know what he had in mind when he said that.

Mr. HORN. Well, he is asking in a memo to James W. Shaw of your office in Denver, he is saying: "Will MMS commit additional audit resources either in the form of MMS auditors or more money for the State of California to do the followup work if the team recommends it? I recognize that this is hard to answer without knowing what the scope may be, but I am hoping for some sort of motherhood statement that I can give the team for our next meeting. I have stalled this issue long enough. Please see the Speir memo I am sending you on this subject."

It seems to me that we have taken an awful long time to get this issue resolved. Are you now on track with that? Could you give us sort of a schedule of how MMS is going to operate in this area now that you have an interagency report and everything else that you know?

Ms. QUARTERMAN. It has taken a long time but the team has accomplished quite a bit in the time that it had available to us. Accessing sealed files from the State of California took several months before they could possibly review that. We audited two companies for 3-year time periods. Just to put that in perspective, on a normal audit cycle for companies of this size, we take 3 years to audit 3 years. We hired two consultants and got their reports back and were able to integrate them.

We went forward on the Interior Board of Land Appeals and asked them to reverse a decision, something that is pretty much up to them to determine how quickly it would happen but it happened within this 2-year timeframe. So it may seem like a long time to some of us on the outside, however, I think it was—they accomplished quite a bit in the timeframe that they were given.

As to how we plan to proceed from here, we will be meeting members of the Department of the Interior, with members of the Department of Justice to get their advice on how to proceed. We will probably make a recommendation to them, and ask them if they have any concerns with that. Once we can resolve those issues, we will move forward hopefully in the next month a final decision on how we plan to preserve this.

Mr. HORN. Mr. Berman, since I quoted you, is that an accurate quote? Could we have collected way back in 1993?

Mr. BERMAN. Could have collected in 1993? Probably not. I recommended that we initiate collection as soon as possible.

Mr. HORN. What are the problems that you found in being able to collect? You have been a number of years I take it in this responsibility?

Mr. BERMAN. Yes. I'm not sure I understand the question.

Mr. HORN. Well, you are familiar with the evaluation problems as an economist. What are the problems here that delay collection? I mean, is it simply MMS starting to do it, or is there a lot that has to be resolved in terms of the pricing system? And maybe you as an economist could educate us on the pricing system.

Mr. BERMAN. I can—I might be able to talk a little bit about the pricing system. The administrative mechanics that MMS goes

through in allocating resources for audits and determining what to audit and when is not an issue that I've gotten into in the past.

Mr. HORN. I can understand that, but has the delay been caused at all by the complexity of the valuation system? Or is it just normal practice and it is a matter of adding it up, price per barrel that goes on every day in this country?

Mr. BERMAN. The valuation—the California market is very complex. If you take a valuation system based on the alternative crude, and the market prices of crude, that would lend toward an ANS valuation system which is more straightforward. A valuation system based on audits is more complex. You have to make sure that you get all the records, that you get all pieces of the records, that there may be multiple transactions involved and the premium may be, because of the trading, may be spread off across numerous transactions. So, the process can be lengthy.

Mr. HORN. I just happened to be glancing at the price list of what they—one company will pay during this last April, and as you suggest, it varies all over the lot. There are roughly 31 different fields in California on the pricing, and there is no rhyme nor reason, in my judgment as a layman who did take a few courses on economics, why some of those fields vary since the posted gravity is exactly the same as it was 8 weeks before, yet some go down and some go up.

Can you enlighten me as an economist as to why some of those prices go down and go up when the posted gravity is exactly the same?

Mr. BERMAN. It is hard to say as an economist. Posted prices are not market prices. These are—I'm not even sure they are always offers of one sort or another. These are statements by the company, initial statements as to what the crude may be worth. It is best likened, I think, to posted prices in a car lot. They are a starting point if you will, perhaps for negotiations.

There is no reason, necessarily, that postings by any two companies would necessarily have to coincide. I'm not particularly disturbed by that at all.

Mr. HORN. Well, thank you. My time is up. And I yield to the ranking minority member for 10 minutes.

Mrs. MALONEY. Thank you very much, Mr. Chairman. I'd like to thank Mr. Berman and Ms. Quarterman for their testimony, and Mr. Haspel.

In late 1993, MMS, the Minerals Management Service, investigated oil royalty payments from 1960 on. Ms. Quarterman, then MMS limited the task force investigation to the 1978 to 1993 years. How far back do you intend to go to collect the royalties?

Ms. QUARTERMAN. At this point in time, the Department has not made a decision on how far back to pursue underpayment of royalties.

As to the statement that we limited the task force, that is not my recollection. We did not limit them in terms of how far they could go back.

Mrs. MALONEY. Well, since the task force report states that 74 percent of the potential undervalued royalty collections are from the years 1980 to 1985, can MMS at least commit to covering 1980 to present?

arm's length transactions for that period once those benchmarks were put in place. Whether or not they work or not, as I mention, we are trying to change them going forward, but for the period that they have been in effect, they are, in fact, the law.

Mrs. MALONEY. I would like to ask you a question about these regulations. To defend MMS' interpretation of them you need, "significant quantities of arm's length transactions." However, the regulations do not define, "significant quantity."

Further, near the end of the task force report page 7, appendix 1, states that less than 20 percent of crude oil is traded at arm's length, but that is not a little amount. But it certainly isn't significant in the context of the market. How can we show that significant quantities of California crude oil is not sold in arm's length transactions?

Ms. QUARTERMAN. I think these are all issues that may come up when we decide to proceed in a methodology that is different from the one that has been recommended by the team for 1988 forward when those regulations were in effect. That is, if we were to go forward with the ANS valuation from 1988 forward we would have to explain I am sure, in litigation to companies why that is different. At this point in time I am not prepared to get into the legal—the underlying legal arguments associated with those recommendations.

Mrs. MALONEY. Do you dispute the task force's finding that ANS spot prices reflect market value in California?

Ms. QUARTERMAN. I have no reason to dispute it or to confirm it.

Mrs. MALONEY. So you are not confirming it or disputing it?

Ms. QUARTERMAN. I accept it on face value.

Mrs. MALONEY. You accept it on face value.

On page 67, the task force report states that documents from the Long Beach case reveal that the companies themselves use ANS as their measure. Why can't we do the same? Why can't we use the same measure that the companies use? And the report states that that is what the companies use.

Ms. QUARTERMAN. It may be—

Mrs. MALONEY. It means \$856 million, too.

Ms. QUARTERMAN. It may be that the Department of the Interior determines that it will use ANS as a valuation point. Again, that has not been decided.

Mrs. MALONEY. When will you make that decision?

Ms. QUARTERMAN. Within the next month.

Mrs. MALONEY. Within the next month.

Why did MMS change the regulations in 1988 to rely more on posted prices when there was mounting evidence to discredit them? And didn't California object to Interior on these grounds specifically? That, I did not understand in the record. Why did MMS change the regulations in 1988 to rely more on posted prices when there was report, after report, after report that they were not proper or fair or did not show fair market value?

Ms. QUARTERMAN. I wasn't at the Department of Interior in 1988. I am afraid I won't be able to answer your question completely. What I know about the regulations that were put into place in 1988 is that they were discussed for a series of many years with

all interested parties at the table; that at the time the regulations were changed from a more general regulation to the one that is in existence now that there had been concerns raised much as this concern has been raised by the clarity of valuation, and the purpose at that time was to clarify.

Mrs. MALONEY. A commonsense answer. After reading all the prior reports that it was wrong, that it was undervalued, the court cases substantiating it, don't you agree on a personal level, on a commonsense level that we shouldn't use posted prices? All evidence points to that.

Ms. QUARTERMAN. We have determined that.

Mrs. MALONEY. You will not use posted prices?

Ms. QUARTERMAN. Only to the extent we are required to by the regulations.

Mrs. MALONEY. Maybe the regulations should be changed if everyone agrees posted prices are wrong. Maybe Congress should write the regulation or give specific guidelines. I don't know if every report says you shouldn't use it and you say maybe if the regulations require it, we will use it. It seems to me common sense that you change—that you go back to fair market value. You don't jump through hoops that make it impossible for you to collect fair market value. My time is up, but I look forward to your response.

Ms. QUARTERMAN. I just wanted to add, as I stated earlier, we are in the process of changing our regulations going forward and clarification that in 1988 when the regulations were put into place, that was shortly following a district court decision in the Long Beach case that found that for the defendants, not for the plaintiffs, it was also during a time period where several Federal agencies were looking into the issue of California crude oil and posted prices and did not reach any firm conclusion one way or the other. I don't want to defend the actions of my predecessors, but just to clarify what was happening at that point in time.

Mr. HORN. Let me draw on the brains of the economists that are here for a minute. You have looked at a lot of different value situations. What are two or three top ways to get a fair market price for the Federal Government and the State governments in this leasing operation? How about you, Mr. Berman?

Mr. BERMAN. The question of market value is perhaps more easily determined than the question of how to collect royalties based on market value. The market value is most easily, most directly given by the prices that come out of the market, the free and fair market.

In the mid continent, for example, the best—one of the best measures we have of this is the pricing that came out of the NYMEX, the prices that are posted daily on the P-plus market out of curbing Prices out of St. James, LA, offer a bench mark for value. On the west coast, the price of ANS is a frequent reference for value.

The question, then, of how to determine value for royalty purposes goes well beyond that. It is how do you account for the differences in the crude? How do you account for locational differences, quality differences, these sorts of things.

Mr. HORN. Let's take that point. Alaska North crude is a higher quality oil than California typically; is that not correct?

Mr. BERMAN. That is correct.

Mr. HORN. There is also a transportation problem; is that not correct? In other words, if I were a refiner I am going to have to pay certain things that have been added to the producer's cost, I would think.

Mr. BERMAN. They say spot market for ANS on the west coast so that transportation issue, the majority of it would be dealt with by that. You'd have a local movement issue to deal with from wherever the market is from wherever you are getting it from?

Mr. HORN. So is the ANS a fair price guide for most of these transactions?

Mr. BERMAN. For California, I think so.

Mr. HORN. OK, regardless of gravity or anything else.

Mr. BERMAN. The gravity, there are typically gravity-based adjustments that are used by traders. The four corners, line 63 has a gravity bank, so that when gravities of different amounts are put into a pipeline, by different people they—everyone gets their fair share coming out the other end.

Mr. HORN. In other words, is the MMS using the same system of valuation as the oil companies do on an intertransfer? And should they?

Mr. BERMAN. The MMS using the same—

Mr. HORN. Well, in terms of pricing some of this oil when there are sales between oil companies, should the Department of the Interior Minerals Management Service be using that same method or is there something wrong with their method?

Mr. BERMAN. You need to test very carefully what is going on in the transaction. If the transaction is between—unaffiliated companies of opposing economic interest, you can establish that opposing interest at the time of the transaction, then it is a transaction that you can probably rely on for that piece of it. But it gets—it is getting very complicated because there is such extensive trading, and the question of whether or not there is opposing interest.

Mr. HORN. Well, let's pick up on that. Mr. Speir, you were on the task force deliberations. What were the parameters of the deliberation as to whether or not the Alaska North Slope prices should be the basis for the royalty benchmark? What can you tell us about the dialog there and does it make sense ultimately?

Mr. SPEIR. I assume your question is in the context of the task force—

Mr. HORN. Right.

Mr. SPEIR (continuing). As opposed to the economics of it.

Mr. HORN. No, I am looking now at the dialog within the task force and the pros and the cons.

Mr. SPEIR. We really never got into the question about whether Alaska North Slope oil was a proper method of valuation in an economic sense. Our decision to the extent that it took place centered more along the lines of could we actually do that within the context of the MMS regulations. And the question of significant quantities comes into play there. The benchmark system that was set up in the 1988 regulations required you to successfully reject four benchmarks before you could get to the point where you could clearly identify an ANS-type valuation as being a proper method under the regulations. And because the significant quantities term was not

defined, it became sort of a subjective judgment about whether we really saw significant quantities of trading taking place.

Given that you choose to make the subjective judgment that all of the other trading that we saw in the contract records were not significant quantities then, can you fall through this benchmark system to the last one and establish ANS as being a method of valuation? There are a couple of other technicalities you have to resolve about sales from the same area over the same type of crude and so on, but I think basically you could do that under the regulations if you choose to make that judgment.

Mr. HORN. Let's look a minute at those four benchmarks. Was that statutorily mandated or was that a regulation developed to carry out the statute?

Mr. SPEIR. My understanding is it is a regulation pursuant to a statute. I am not familiar with the underlying statute myself, but my perception was it was much more general.

Mr. HORN. Did the task force feel that those benchmarks made sense or should they be basically revised?

Mr. SPEIR. In general, we felt that a significant amount of revision is appropriate for the 1988 regulations. We didn't specifically say how we would revise the benchmarks, but in our deliberations we all had problems with attempting to apply those to the situation which saw it hand mostly because of the necessity to reject one and consider another and reject that. Well, I think that answers your question.

Mr. HORN. It seems to me if you have an unworkable formula the question is should the unworkable formula be changed and what is a fair, equitable, reasonable formula that withstands the test of a court and would stand the test of scrutiny by an intelligent, informed citizen? In other words, should we go back to the drawing board in the Department of the Interior?

Mr. SPEIR. Well, it certainly requires a lot of consideration. The regulations, as they stand right now, have terminology that is crucial and critical to the interpretation, which is not defined in any way, either loosely or tightly. Significant quantities, the nature of an affiliate transaction, which really gave rise to decisions in the LA case that was talked about earlier, all of that should be cleaned up within the current framework.

If you extend that question to how should we obtain the proper value for the oil under the regulations, I think that should be the subject of considerable study. The Department of Energy, of course, and the city of Long Beach take a quite different approach to selling their oil and we always have.

We have never accepted posted prices, and the situation with the city of Long Beach actually gave rise to the lawsuit you were talking about. The city of Long Beach really doesn't do that anymore. There are other broader considerations to take a look at.

Mr. HORN. Are you familiar at all with the University of Texas methods of royalties and leasing? Anybody at the Interior familiar with that?

Mr. SPEIR. I am not.

Mr. HORN. I would suggest that maybe they become familiar because I am informed that that is one of the most effective leasing royalty systems in America, to get the money they want to get for

Mrs. MALONEY. The MMS members of the task force in recommending auditing for premia rather than using—in the task force report, as you know, there was a difference of opinion, the MMS members recommended auditing for premia rather than using MMS, do you believe this is the most effective method?

Mr. BERMAN. As a matter of collecting royalties, that would be an issue for the Solicitor as a matter of determining—

Mrs. MALONEY. I am not asking a bureaucratic mumbajumbo. I am asking a person who is paid by the taxpayers to research this. I am asking your opinion, your opinion—if you were on the task force—you should have been on it given your background—if you were on it, which side would you have sided with? Would you have sided with MMS or what was Energy and Commerce—Energy and Commerce, which side would you have gone, MMS or premia?

Mr. BERMAN. I believe the best method of measuring value in California is through reference to ANS, since ANS was entered into California markets.

~~Mrs. MALONEY. Can you explain to the committee, to Mr. Horn and me, what is the relationship between ANS spot price to postings and premia paid above postings?~~

Mr. BERMAN. ANS is market crude in California, that is it is a heavily traded crude. It is a very important crude to the refiners in transportation fuel. It is, in fact, then the—as a heavily traded crude it will form the basis for valuing exchanges between companies. That is to ensure that they get the proper value when they deal with one another.

Posted prices, as I indicated before, represent the company's statement of—or initial statement about the market in the field, or at any one point they don't represent market transactions. In a well-functioning market one would expect the premia on the posting to correspond with the market value as it does in the mid-continent market. The problems in the California market, the lack of trades and the transportation restrictions will inhibit this to a significant extent. But the premia then would tend to capture some of the market value.

Mrs. MALONEY. One section of the task force numbers, the MMS ones, recommended relying on Benchmark 1 of the regs, which again relies on posted prices on significant quantities of arm's-length transactions. Does this recommendation make sense to you? Is it possible under the regulations to use ANS as the determiner? Just yes or no.

Mr. BERMAN. Yes, ma'am.

Mrs. MALONEY. And I was confused. Maybe as an economist you can answer this. What constitutes "significant quantities"? Is less than 20 percent significant? What is "significant"?

Mr. BERMAN. It is not that simple. If it was as simple as saying 20 percent was a significant quantity, then we could have done that in the regulations.

The reason it's not in the regulations is because it's not simple. In my mind, the quantity is a significant quantity if you can establish a market price about that quantity.

Mrs. MALONEY. Is ANS significant?

Mr. BERMAN. Yes, ma'am.

Mrs. MALONEY. And why is it significant?

Mr. BERMAN. It is readily available. There is an established spot price on the amount. It's bought and sold at the prices—at those market prices, and it's relied on by the companies as a reference.

Mrs. MALONEY. And have you continued to pursue this question enough to know if this is just limited to California?

Mr. BERMAN. I have initiated an investigation to look at the issue of posted prices generally in the mid-continent, Texas and New Mexico, et cetera.

Mrs. MALONEY. Are those posted prices undervalued in your initial research?

Mr. BERMAN. My initial findings are that those posted prices are below what is generally regarded as market value.

Mrs. MALONEY. And have you only done it in two States? Is that correct, in addition to California?

Mr. BERMAN. I haven't done it in detail in any State. I have been looking at the trading issue generally. It's much easier to look at a broader market outside of California since there are not the transportation restrictions that there are in California and you can find similar market references that can be used in New Mexico or in Texas.

It's more difficult to do that in California. But I found that, as a general rule, that postings do not reflect market value.

Mrs. MALONEY. May the committee have the results of your investigation so far for our study?

Mr. BERMAN. It's really in pieces in my office. I would—I haven't even had a chance to brief my superiors on where we are yet. I'm not—I would be more than happy to provide anything through our Congressional Affairs Office, if it's—if the Department deems it ready to be seen.

Mrs. MALONEY. Thank you very much.

Mr. HORN. Thank you very much.

Let me just ask you one question, Mr. Berman. You are a very expert witness here. In your studies in the use of the price structure, you have advocated namely the Alaska North Slope structure. Do you have any ballpark figure as to what we might be losing as a result of not adopting that particular price structure as an index of what is value? Are we talking hundreds of millions of dollars that we are foregoing by not doing it, or what?

Mr. BERMAN. Well, I would not use—it is not clear that I would use Alaskan North Slope outside of the State of California.

Mr. HORN. OK. What would you use in the mid-continent and Texas?

Mr. BERMAN. Mid-continent and Texas, I would probably use—

Mr. HORN. East Texas?

Mr. BERMAN. Closing price on the NYMEX when it goes from future to spot. Or I would use on a daily basis, I would use the NYMEX or the postings plus, P-plus market out of Cushing. Possibly, for economic reference, the light Louisiana sweet out of St. James. It would depend on the market that I was looking at.

Mr. HORN. Because we would appreciate that ballpark figure. If we are losing a few hundred million, I think we have a little bit of concern here—quite a bit of concern.

Mrs. MALONEY. Were you at any of the task force meetings?

Mr. HASPEL. No, I was not.

Mrs. MALONEY. So, when were you briefed to testify about the task force on which you were not a member?

Mr. HASPEL. I was aware of the existence of the task force, that Bob was on the task force. I was aware of where the task force was going because I am familiar with royalty issues, but I was only formally briefed on Friday to prepare for this testimony.

Mrs. MALONEY. So Mr. Speir is your assistant?

Mr. HASPEL. He works for me, yes.

Mrs. MALONEY. Then I would like to ask him: Mr. Speir, were you a member of the task force?

Mr. SPEIR. Yes, ma'am, I was.

Mrs. MALONEY. From the beginning to the end?

Mr. SPEIR. Yes.

Mrs. MALONEY. I'd like to ask a few questions about the task force, specifically page 67 of the task force report. Energy and Commerce representatives recommended using the Alaska North Slope spot price to determine what royalties the oil industry should be paying the Federal Government.

Could you explain why there was this division and why Energy and Commerce supported the ANS prices? Very briefly?

Mr. SPEIR. Well, briefly, we felt that that was the proper valuation of the crude oil.

Mrs. MALONEY. Why?

Mr. SPEIR. It was a—the prices that we were talking about were free and open market transactions. They were readily relatable to California crude oil, because although the density of the oil is somewhat different in some cases, there were readily available industry adjustment factors. ANS was within the range of California oil, so—quality-wise, so the adjustment for transportation and quality was a reasonable thing to do, and we saw the industry doing it themselves in the records.

Mrs. MALONEY. You saw in the records? Could you speak further; how did you see it in the records? Did Energy tell you that is how they used it? Was that their method? Did they tell you, or did you see it in documents?

Mr. SPEIR. No, in our examination of the Long Beach records, we saw a number of instances where companies were analyzing the value of California crude oil they were buying to them and making that analysis relative to Alaska North Slope oil prices and making comments to the effect that California oil was far below its value.

Mrs. MALONEY. And that was in writing?

Mr. SPEIR. Posted prices. Yes, ma'am.

Mrs. MALONEY. Wow, Mr. Chairman. On page 57 of the task force report, "Energy does not recommend using ANS for post-1988." Does that mean you agree with MMS that auditing for premia is preferable to using ANS post-1988?

Mr. SPEIR. Well, I have always felt that Alaska North Slope oil is the proper basis of valuation. I mean, that doesn't change after 1988. The significant difference was in the change in regulations. And this benchmark system that required a judgment of significant quantities before you could reject one benchmark and fall down to the next one, that was simply a confusing situation, combined with

the fact that most of the dollars that might be obtained in overcharge settlements or judgments were in the 1980 to 1985 period. I went along with the MMS's feelings that the benchmark system should be used.

Mrs. MALONEY. OK.

Mr. SPEIR. And I might add, a benchmark system should be used as applied to sales premia that were seen in contracts, not posted price.

Mrs. MALONEY. OK. I'm a little confused. You believe that the post-1988 Federal regulations could permit one to value crude at the ANS spot prices for royalty purposes, taking into account gravity and transportation?

Mr. SPEIR. I believe they could, yes. It requires you to make certain judgments, which are largely qualitative judgments, about whether the trading activity that you see in company records was, quote, significant or not significant. If you deemed that the activity, real true arm's length sales and purchases at posted prices or posted prices plus a premium, was not a significant quantity, then you could fall down to the next valuation benchmark, and benchmark No. 5 clearly would allow you to use ANS as a candid valuation system.

Mrs. MALONEY. But jumping over, the other benchmarks are very difficult.

Mr. SPEIR. Because of this subjective judgment about what constitutes a significant quantity.

Mrs. MALONEY. What do you think constitutes a significant quantity?

Mr. SPEIR. I can't make any judgment about that.

Mrs. MALONEY. So then you agree with Ms. Quarterman that the regs need to be rewritten?

Mr. SPEIR. I think we all agree, all of the task force agreed, that the regs need substantial revision, yes.

Mrs. MALONEY. In appendix 1, page 2, the task force argues that they cannot use the ANS spot price method because the regulations require that the crude oil used as the determiner of value come from the same "area." Could ANS be considered from the same area, for comparison's sake, to California?

Mr. SPEIR. Well, it is certainly sold in the same area. It is sold in the Los Angeles spot market. That is the price that Dr. Leitzinger was looking at when he did the side study that Mr. Armstrong just spoke to. It's not produced in the same area, but everyone recognizes that ANS prices are a dominant factor in the California market, and clearly it is refined in the same refineries in California that refine California crude oil.

Mrs. MALONEY. On page 11, "Energy and the Commerce Department representatives recommend going back to at least 1980 to collect undervalued royalties." Why? And would you elaborate.

Mr. SPEIR. Well, first of all, we looked at the year-by-year potentially collectable royalty underpayments, and we found that the majority of those potentially collectable royalty underpayments accrued in the years 1980 to 1985 when prices were high.

We sort of went at it from two different directions. We looked at how much you would obtain for each incremental year going back

15

United States Crude Oil Royalty Payment Regulations

Suggested Modifications Presented 9/5/96

J. Benjamin Johnson

Summit Resource Management, Inc.



Payment Regulation Discussion **Outline**

- **Current Crude Oil Marketing Practices**
- **Goals of New Payment Regulations**
- **Conceptual Basis**
- **Suggested Changes to Existing Regulations**
- **Implementation of Suggested Changes**
- **Administration of New System**

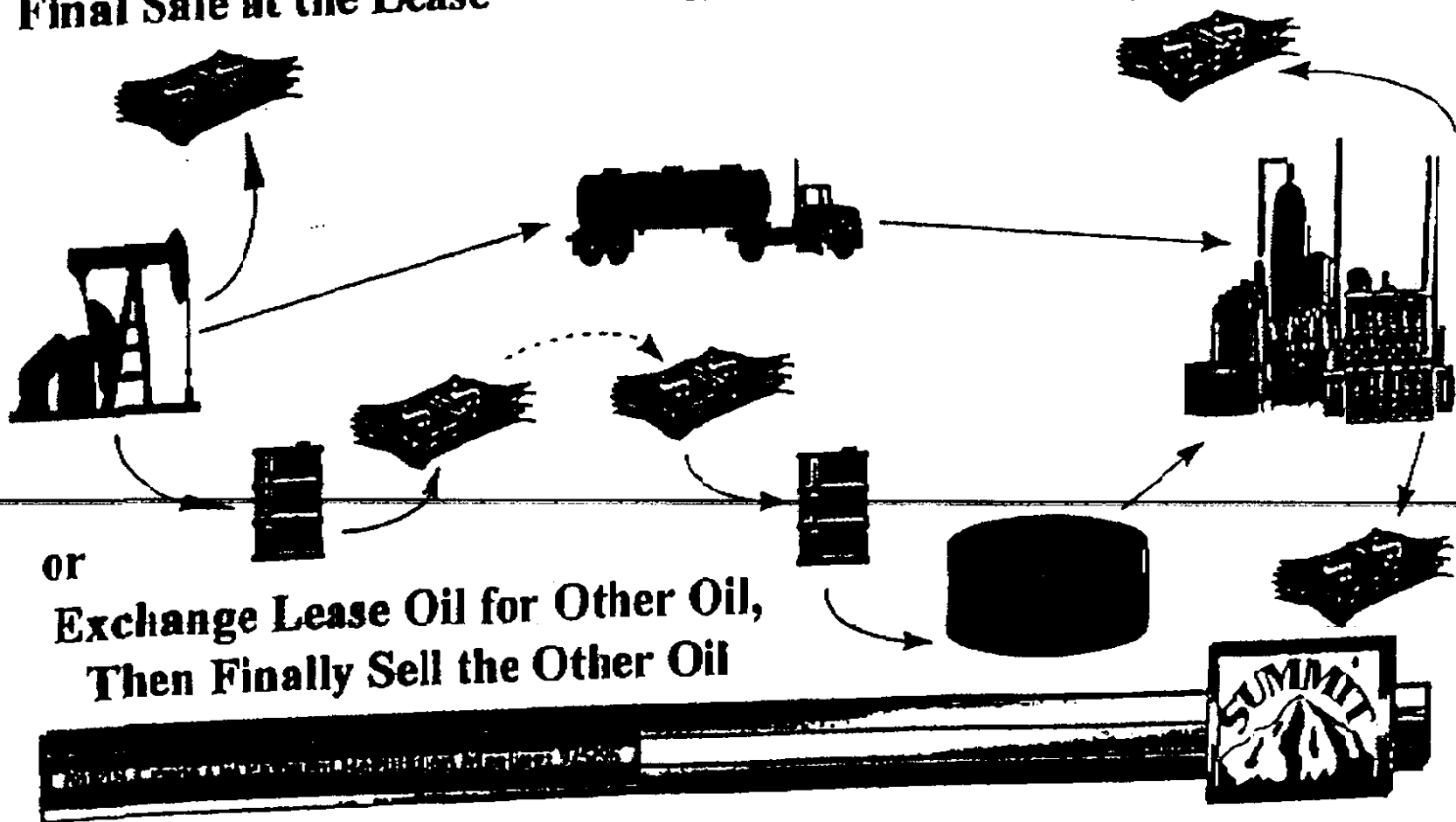


Three Basic Methods to Market Lease Crude Oil

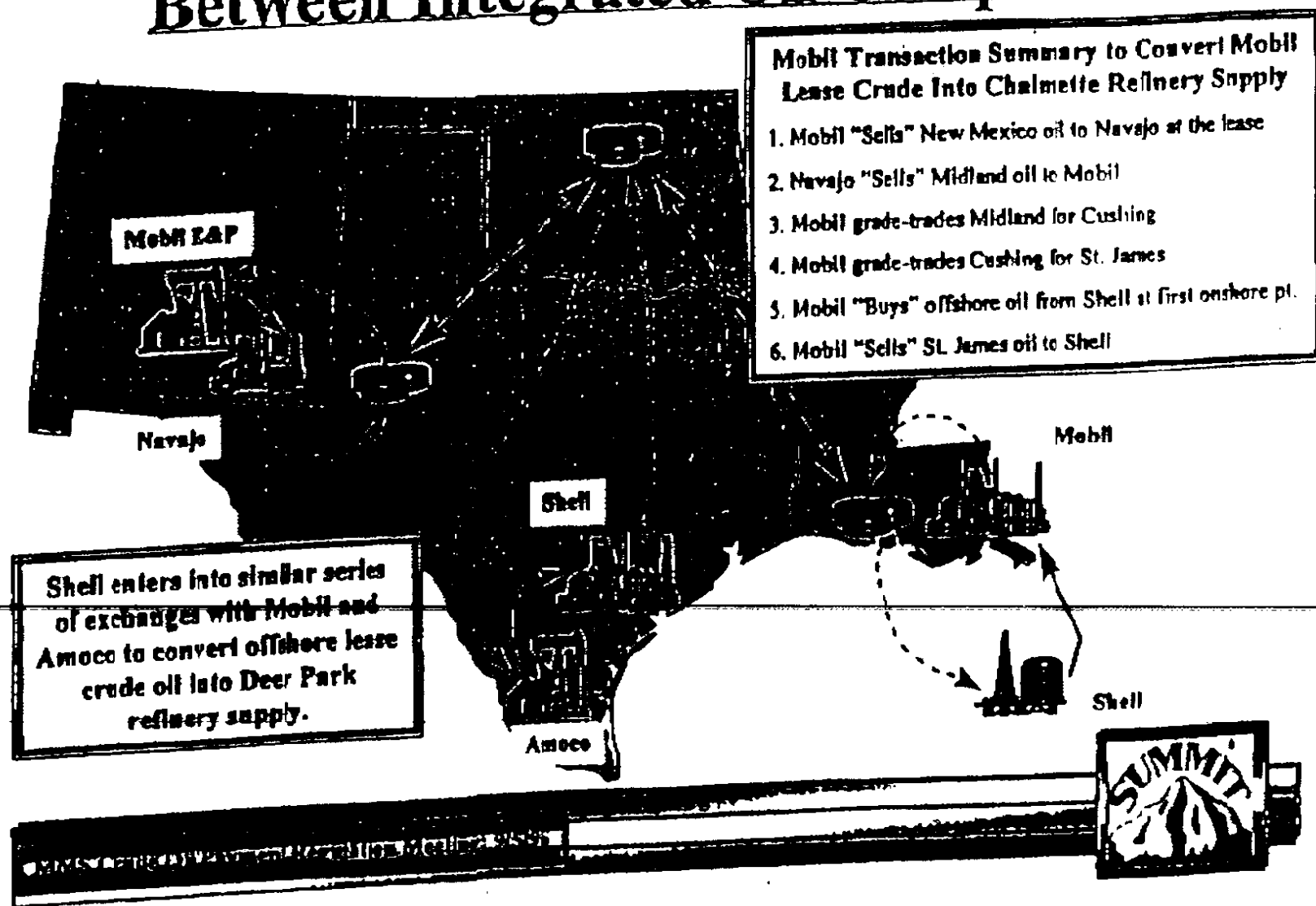
Final Sale at the Lease

or

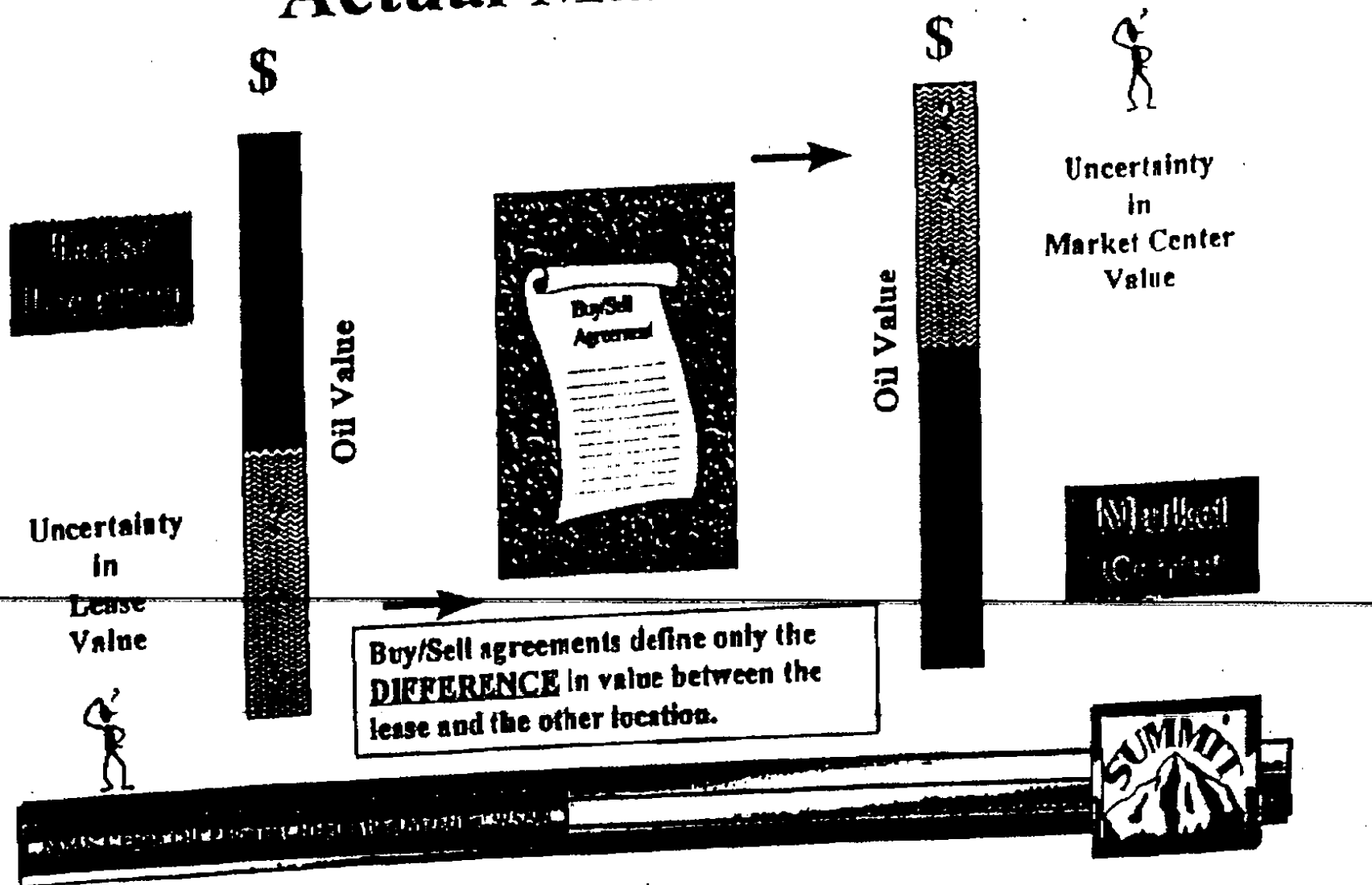
**Transport to a
Purchaser, Then Sell**



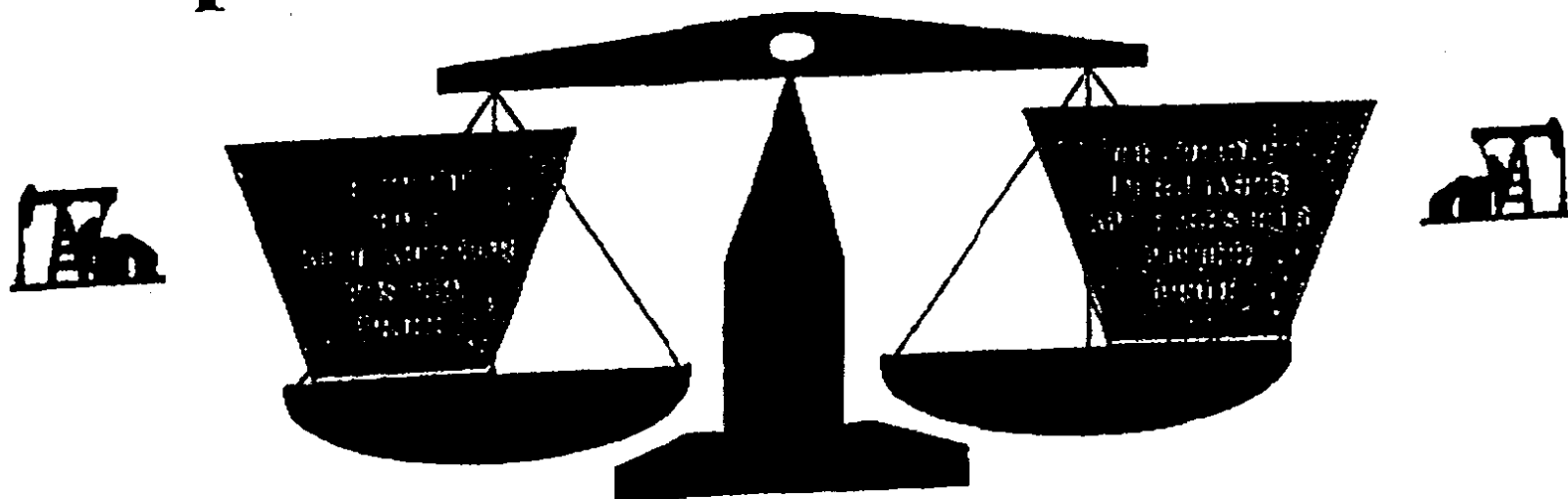
Typical Crude Oil Marketing Relationships Between Integrated Oil Companies



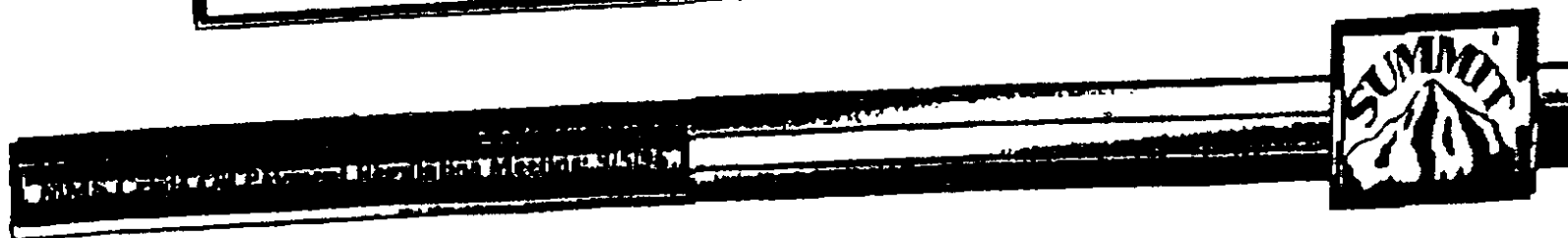
Buy/Sell Agreements Do Not Show Actual Market Value



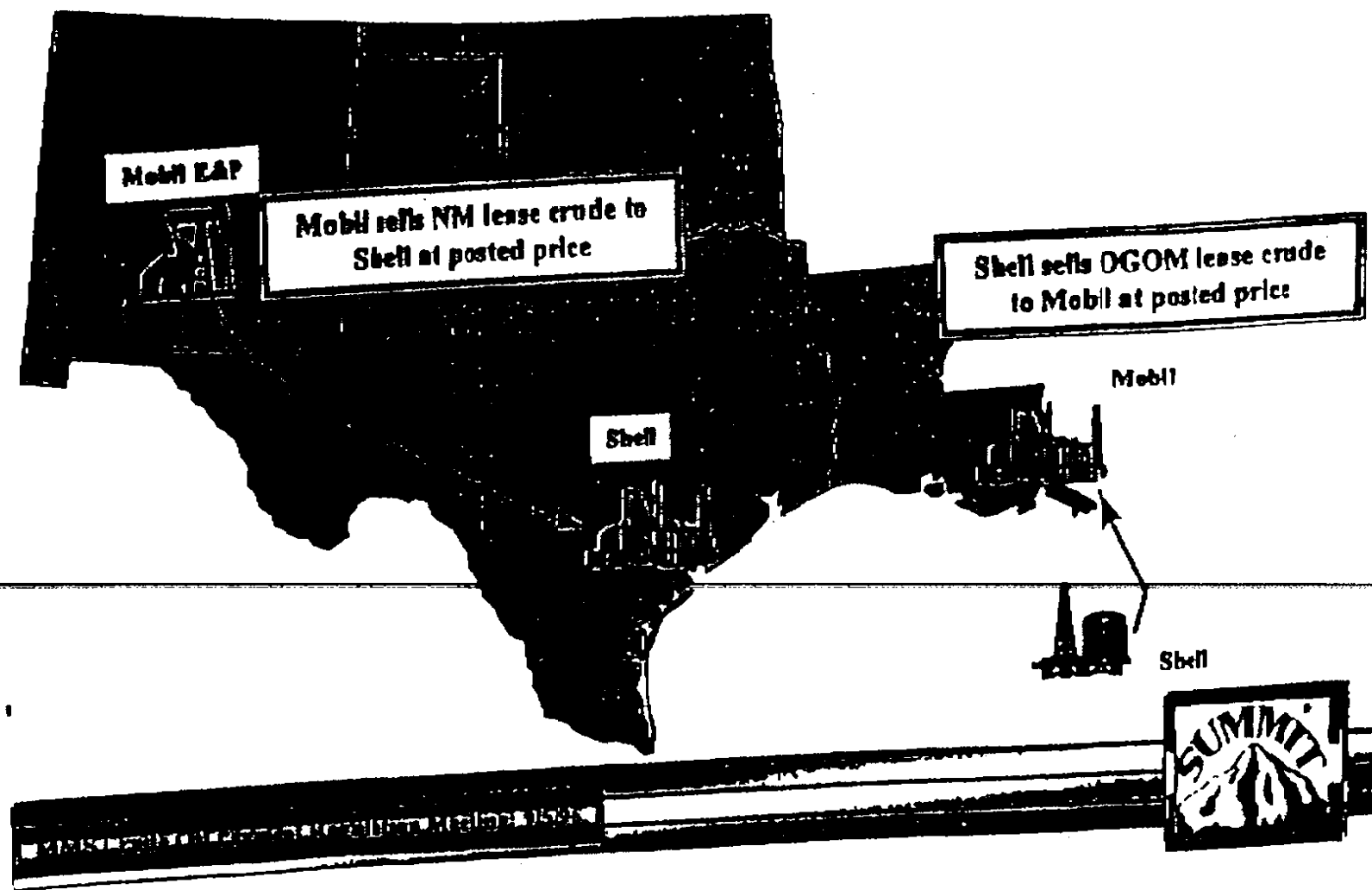
"Overall Balance": Implied Exchange Transaction



As long as two companies sell approximately equal volumes to each other, the ~~absolute price isn't~~ important. In fact, because of reduced royalty and severance tax payments, the volumes don't even have to be exactly equal for both parties to benefit from setting the posted lease prices below full value. There may not even be written contracts reflecting the exchanges.



Example of Overall Balance



Crude Oil Value Affected By Quality

- API gravity scales in Posted Prices are sometimes used
- Most actual lease marketing contracts "*deem*" API gravity when deductions are applied to posted price bases
- Actual deductions for crude oil quality are usually negotiated
- Some market centers have "gravity banks" to adjust price for quality



FOR MORE INFORMATION CONTACT THE ENERGY DIVISION

Summary of Current Crude Oil Marketing Practices

- Few truly outright sales by major producers
- Independents commonly sell outright
 - Many Independents use sophisticated sales
- Most Majors utilize buy/sell exchanges
- Overall Balance concept used by several Majors
- Price adjustments for quality are commonly negotiated on each contract



Existing MMS Payment Regulations

Valuation Standards (CFR Ch II 206.102)

(h):

“Notwithstanding any other provision of this section, under no circumstances shall the value of production, for royalty purposes, be less than the gross proceeds accruing to the lessee ...”

Gross Proceeds: “... the total monies and other consideration accruing to an oil and gas lessee ...”

(j):

“Value shall be based on the highest price a prudent lessee can receive ...”



Goals of Revised Regulations

- **Fair to Payors and Federal Government**
 - Meets obligations of lease agreements
- **Understandable**
 - To Payors
 - To MMS Auditors
- **Minimal changes to existing system**
- **Compatible with Payors' existing systems**
- **Compatible with actual marketplace**
- **Difficult for Payors to manipulate**

AMERICAN OVERSIGHT



Current MMS Crude Oil Payment Regulations - Issues

- Current regulations require payment on full value received, but changes could better reflect actual marketing practices
 - Current reg's seem to assume that posted prices may represent "market value" of lease crude oil
 - Posted prices can be arbitrarily set by Payors
 - Current reg's do not readily acknowledge common buy/sell contracts or non-arms-length sales
 - "First Sale" price can easily be manipulated to hide actual value received for lease crude oil

CHANGING THE WAY WE DO BUSINESS



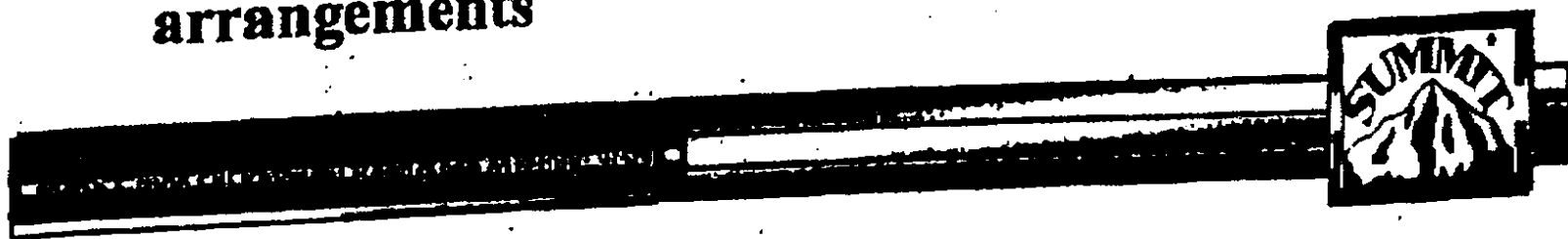
Challenges in Developing Revised Payment Regulations

- Any system can be manipulated
- There is no "perfect" system
- Balance between:
 - Accuracy in recognizing full value received
 - Ease in auditing and compliance monitoring



Two Conceptual Approaches to Royalty Payment Obligations:

- **Actual value received for oil at the lease:**
 - Recognizes full value obtained by prudent oil producers
 - Difficult to audit and detect underpayments
- **General "Market Value" basis:**
 - Easy to ensure that payments equal value basis
 - ~~Difficult or impossible to determine the appropriate~~
"Market Value" without access to actual marketing arrangements



“Actual Value” Payment Issues

- **Requires complete disclosure of marketing arrangements by Payor**
 - **Ensure that sales were arms-length**
 - **No other value received in return for lease crude oil**
 - **Includes service discounts, discounts on other sales, etc.**
 - **No affiliation between Buyer and Seller**
- **Actual Value may be sales or exchanges**
 - **How far downstream to follow exchanges?**
- **Easy compliance for some payors**



“Actual Value” Payment Issues

(cont.)

- **Reporting and paying federal royalties on actual receipts may divulge proprietary marketing arrangements**
 - **Some states require payment of all royalties on the same price**
- **Burden of Proof must be on Payor to show actual value received**
 - **Marketing arrangements must meet several strict audit tests**



ALL INFORMATION CONTAINED HEREIN IS UNCLASSIFIED

"Market Value" Payment Issues

- **Option 1: Purely theoretical application**
 - **"Net-back" calculation**
 - **Market center spot value**
 - What basis?
 - **Published transportation deduction**
 - Potential overstatement of transport deduction
 - **Quality deduction**
 - What basis for determining quality valuation?
 - **Assumes that MMS knows at least as much about specific lease crude oil value as the producers**
 - **Difficult without access to actual market data**



FOR MORE INFORMATION, CONTACT THE MMS INFORMATION CENTER AT 1-800-451-4741

“Market Value” Payment Issues **(cont.)**

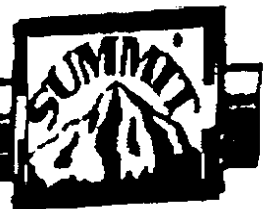
- **Option 2 (recommended): Use of Actual data to compile an “average” for each area**
 - **Should be based on “exchange pricing” rather than absolute**
 - **Exchange differences do not change often**
 - **Actual market factors in known areas can be extended to develop theoretical values for application in cases where no actual values are reported**



Suggested Revised Payment Basis

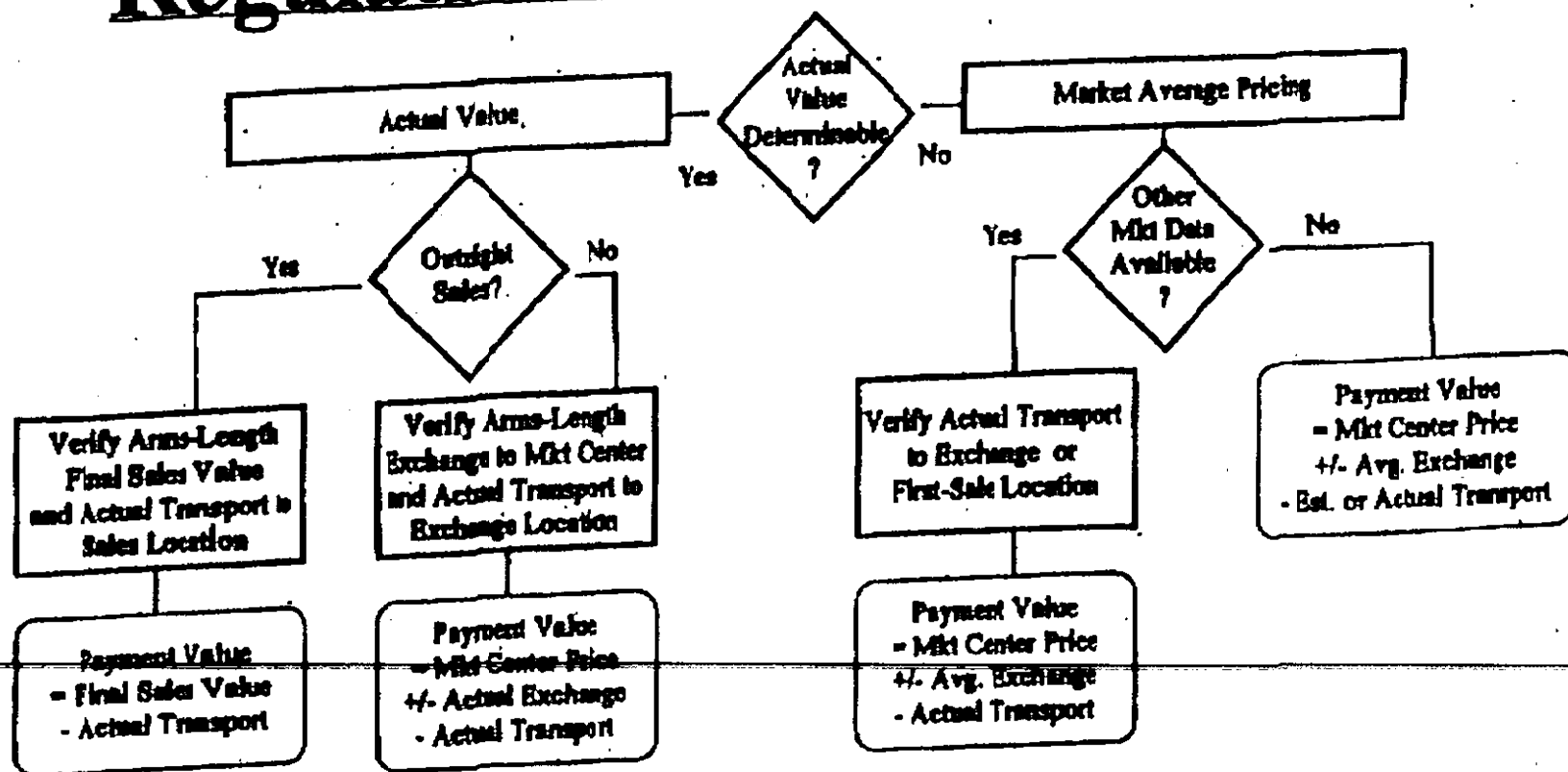
Summary

- All payors provide MMS with complete marketing information
 - Kept confidential by MMS
- Valuation basis:
 - If actual value or actual exchange to market center is known, use actual value received:
 - Outright sale
 - Exchange to market center
 - If actual value or exchange not known, use Market Average Pricing
 - Established by MMS based on actual reported data



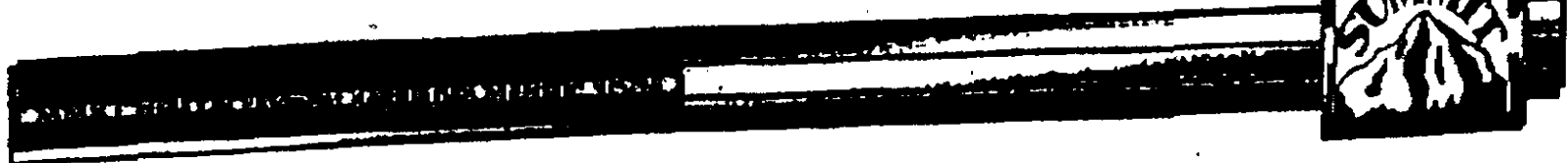
CONFIDENTIAL - NOT FOR DISTRIBUTION

Suggested Revised Payment Regulation Flow Chart Summary



Required Data Provided to MMS

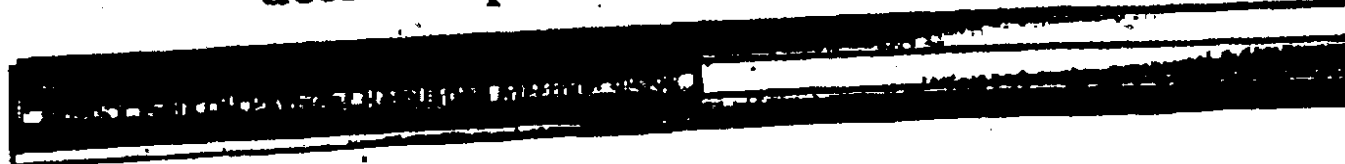
- **Outright sale terms**
 - **Declare if arms-length sale**
 - **Define price basis and premiums**
 - **Include all formulae used**
 - **Define actual transportation costs from lease to sale location**
 - **If using buy/sell for transport, define all buy/sell terms**
 - **Define actual quality adjustment terms**
 - **List actual quality parameters (API, S, ...) if using a "deemed" price adjustment factor**



Required Data Provided to MMS

(cont.)

- **Exchange terms**
 - Declare if arms-length exchange
 - All pricing terms and formulae for all locations
 - Location of each exchange point
 - Define actual transportation costs from lease to first-sale location
 - If using buy/sell for transport, define all buy/sell terms
 - Define actual quality adjustment terms
 - List actual quality parameters (API, S, ...) if using a "deemed" price adjustment factor



Market Average Price Basis **Recommendation**

- Use “Adjusted NYMEX Settle” or “Posting-Plus” as Basis for Cushing, OK Delivery Price
 - “Adjusted NYMEX Settle” is similar to “Posting-Plus”, except that no posted prices are required
 - Continues natural hedge for refiners like posting
 - Oil conceptually priced during delivery like posting
 - Can be exactly bought/hedged/traded/sold on the NYMEX settle prices
 - Corrects arbitrage potential from simply using NYMEX settle prices alone

